

APPENDIX C

**GUIDE FOR
PROCUREMENT OF AUDIT SERVICES
BY
LEGAL SERVICES CORPORATION GRANTEES**

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FOREWORD

In recent years, much attention has been focused on the quality of audits of entities that receive federal assistance. This has been particularly true since the passage of the Single Audit Act of 1984, which requires a single, comprehensive financial and compliance audit of many entities receiving federal funds. The Congress, the General Accounting Office, inspectors general, state and local governments, and the accounting profession itself have all expressed concern about the quality of these audits. These groups have undertaken a number of significant actions during the past several years to address such concerns.

In its semiannual report, *Quality of Non-Federal Audits for the Six-Month Period Ended March 31, 1994*, the President's Council on Integrity & Efficiency (PCIE) reported that approximately 18 percent of the Independent Public Accountant reports issued from October 1, 1993 through March 31, 1994, required major changes or contained significant inadequacies. During those six months, over 80 percent of the audits subjected to a Quality Control Review by the PCIE required major changes or were significantly inadequate. Furthermore, 42 percent of the LSC grant recipient audits subjected to a Quality Assurance Review by the Office of Inspector General were of marginal or substandard quality.

Because we believe that approaching procurement systematically is the best way to ensure a quality audit, whatever the size or complexity of the entity, this guide suggests such an approach.

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INTRODUCTION

No matter the size of your organization, an effective audit can improve management operations and yield significant dollar savings. It can also help avoid wasting your organization's scarce resources on a substandard audit. This guide can help get the most for your money. An audit:

Verifies financial transactions and determines whether grant funds were expended according to applicable laws, regulations and procedures;

Provides LSC management with more timely reporting by recipients and IPAs of noncompliance with Laws and Regulations;

Provides the Congress, LSC and grantee management with objective appraisals of financial accounting systems and administrative controls; and

Determines reliability of financial records and reports.

A U. S. General Accounting Office (GAO) report¹ showed that entities with ineffective audit procurement systems stood a 46 percent chance of receiving a substandard audit; that figure dropped to 17 percent for entities that followed systematic audit procurement practices.

This guide is based on guidance developed by the GAO, the National Intergovernmental Audit Forum, the Western Intergovernmental Audit Forum, the Single Audit Information Service and the LSC Audit Guide. This guide is consistent with the requirements of the procurement standards of the common rule for state and local government grant administration (§__.36) and OMB Circular A-110 (§ __.40-__.48).

PLANNING: AN ESSENTIAL FIRST STEP

Planning to obtain a quality audit requires time and attention. However, the resources spent on planning are likely to be rewarded by a smooth, timely and less expensive audit.

Determining the specific audit requirements. To find out your audit requirements - a sometimes difficult task - your organization may want to seek the assistance of knowledgeable persons. This assistance is ideally provided by an audit committee composed of people with backgrounds in accounting, auditing, finance or management. Grantees without audit committees may want to seek the assistance of LSC or other LSC grant recipients.

Identifying the attributes necessary in an auditor. We suggest that the personnel doing the audit have experience with audits of other LSC grant recipients or similar entities. Moreover, they

¹CPA Audit Quality: A Framework for Procuring Audit Services (GAO/AFMD-87-34, Aug. 18, 1987).

must comply with applicable *Government Auditing Standards* requirements for peer review and continuing professional education.

Deciding how to evaluate prospective audit firms. Developing a systematic procedure for evaluating firms' qualifications is essential. Although price is important, technical qualifications should be a critical measure in selecting an auditor.

Reviewing legal requirements. Review applicable laws, regulations and grant conditions to ensure that the procurement process and the audit meet legal requirements.

Considering a multiyear agreement. The first year of an audit engagement usually involves significant start-up costs for an auditor because of the time needed to learn about an organization and its internal control structure. After completing this groundwork, the auditor usually can work at less cost in the succeeding years. A multiyear agreement has a dual advantage: it enables an auditor to propose a price that considers the savings to be realized in subsequent years and saves your organization the costs associated with repeating the selection process. However, contracts or engagement letters should also contain an escape clause that would allow, without significant penalty, modification or cancellation made necessary by changes in the law.

Evaluating the auditor rotation option. Some people argue that changing auditors at the end of a multiyear contract infuses the audit process with fresh views and new perspectives. Others contend that these benefits can be achieved through internal rotation of audit staff and that maintaining a long-term, ongoing relationship with a particular auditor is more advantageous. A long-term relationship with a firm, however, will not necessarily enable your organization to seek out and take advantage of lower priced audits. Carefully consider the advantages and disadvantages of auditor rotation before setting a policy.

Establish a work schedule. Develop a schedule that sets dates for achieving certain milestones in the audit process. The only way to ensure the timely preparation and issuance of financial statements and related reports is to develop and follow such a schedule.

All these suggestions - especially creating and using an audit committee - can help a small entity achieve a quality audit. Even the smallest organization can appoint a two or three-person audit committee that understands what is to be audited and how the audit should be done.

COMPETITION AND SOLICITATION: COMMUNICATING AUDIT REQUIREMENTS

Full and open competition is basic to public funds oversight and responsibility. Encouraging as many qualified audit firms as possible to submit audit proposals increases the likelihood of receiving a quality audit at a fair price. The next step, then, is to express your audit needs to potential

bidders.² This step is critical because bidders who do not clearly understand exactly what services are wanted might not respond.

Solicitation. There are many ways to solicit bids for audits, but the most reliable method - and the one we suggest - is a written request for proposal, or RFP. RFPs should be clearly written; setting forth all terms, conditions and evaluation criteria and the scope of the work required.

All potential bidders must understand the requirements of the audit and environment of your organization. Using your audit committee's advice when writing an RFP is a good idea. Committee members should have a clear understanding of both the audit function and what your organization requires of the audit.

The RFP must be sufficiently distributed and publicized to ensure open competition. Consider compiling a list of potential auditors from general and professional directories and from experiences with audit firms. Your state society of CPAs, state Board of Accountancy and other LSC grant recipients are excellent sources of potential auditors. A list of state CPA societies, including addresses and telephone numbers, is included in this brochure.

It is important to design technical and cost proposal instructions that enable consistent evaluation of proposals using applied evaluation criteria. The provisions listed below should be included in an RFP. These provisions can be adapted depending on the size of your entity.

Administrative Information

Background information on your organization

Schedule of funds by project or grant

Description and magnitude of your accounting records

Description of your computer system (if applicable)

Fiscal period to be audited

Term of contract engagement

Availability of prior audit reports and working papers

Time Requirements

Date records would be ready for audit

²This guide uses the term "bidder" to mean "proposer" or "offeror."

Deadlines for completing interim phases, such as fieldwork and draft report preparation

Contract award date

Final report due date

Working paper retention requirements

Requirements for making work papers available to LSC and other grantors

Work and Reporting Requirements

Auditing standards to be followed

Extent of assistance your organization will provide the auditor

Specific scope of audit work to be done

Number and types of reports required

Exit conference requirements

Specific audit guide or program to be followed

Additional audit requirements under LSC Compliance Supplement

Minimum audit requirements under applicable laws, such as the LSC Act

Proposal Information

Evaluation criteria against which the proposal will be judged

Your right to reject the proposal

Contractual Information

Recourse in case of poor quality work

Equal employment opportunity clause

Termination of contract provisions

Administrative and/or legal remedies for contract violations

Bidders' Conference

Although your organization will have been as thorough as possible in preparing your RFP, some information that prospective bidders will find useful may be overlooked. One effective way of communicating additional information to bidders is a bidders' conference. At a bidders' conference, additional information is provided and prospective bidders can ask any unanswered questions. Letters and individual conversations could serve the same purposes; however, bringing all bidders together simultaneously to hear the same information is efficient and helps ensure all bidders are treated equally.

Small Entities

Obtaining an extensive list of potential bidders may be difficult for small entities in rural areas. Soliciting lists from your respective state society of CPAs, other larger LSC grant recipients and from CPAs in your region that have experience with similar entities is often helpful.

Furthermore, preparing a detailed RFP for a small engagement may be economically impractical. Abbreviated RFPs, designed for small engagements, can be designed through tailoring to meet individual needs. At a minimum, such RFPs should clearly define the work including the reports and opinions required.

Technical Evaluation

Methods for evaluating the technical merit of each audit firm's proposal should be developed. These should include the evaluation criteria and their importance in choosing the audit firm best able to do the audit. The following are some critical factors for evaluating audit proposals:

Responsiveness of the proposal as demonstrated by the necessity and adequacy of proposed procedures, reasonableness of time estimates and timeliness of expected completion, and appropriateness of assigned staff levels;

Qualifications of staff who will be assigned to the engagement;

Size and location of the firm;

The range of activities performed by the firm;

The firm's participation in training and continuing professional education in auditing organizations and programs receiving federal funds;

A description of the firm's quality control procedures;

Results of internal and external quality control reviews of the firm;

Time frames for the field work;

The firm's data processing capabilities;

The amount of assistance the firm expects from your organization;

Whether the firm is licensed to practice in the applicable state; and

Assurance that the firm's staff meets the independence standards outlined in *Government Auditing Standards*.

WRITTEN AGREEMENT: DOCUMENTING EXPECTATIONS

The lack of a written agreement between your organization and the audit firm can contribute to substandard audits by public accountants. To foster sound and productive communication and to avoid misunderstandings, both parties should agree in writing on important audit-related matters. Make clear at the start - before bidders spend time assessing the nature of the job and estimating its costs - that your organization expects to sign a formal document as the culmination of the proposal process. Audit firms unwilling to commit to signing such a document are better avoided. Paragraph I-9.B of the LSC Audit Guide provides additional guidance for written agreements.

What to Include in a Written Agreement

When using an RFP, the written agreement should incorporate by reference the terms of the RFP and those of the successful bidder's last proposal. The written agreement will then clearly specify the:

Audit scope, objective and purpose;

Deadlines for work to be done;

Audit cost;

Report format;

Type and timing of support by your organization to the auditor; and

Professional auditing standards to be followed in performing the audit.

Furthermore, the agreement should make the following points about the auditor/entity relationship, changes in the kind or amount of work required, and access to and ownership of audit products.

The relationship of the auditing firm to your organization is that of independent contractor.

At any time, your organization may, by written notice, make changes in or additions to work or services within the general scope of the agreement. If such changes are made, an equitable adjustment will be made in the cost of the audit using the rates specified in the agreement.

If the contractor believes that a change in or addition to work is beyond the general scope of the agreement, it must notify your organization in writing within a specified time and before beginning that work. The agreement should state where the final administrative authority rests in deciding disputes.

The work papers prepared by the contracting auditor during the audit are its own property. These documents should be retained for the period designated in the LSC Audit Guide and available to authorized representatives of your organization, LSC and the GAO upon request.

All reports by the contracting auditor to your organization are the exclusive property of your organization and subject to its use and controls, according to applicable laws and regulations.

Small Entities

Without an RFP, many small engagements are documented with an engagement letter. The engagement letter is typically prepared by the CPA and protects the CPA more than the entity being audited. If your organization decides to use an engagement letter as the written agreement, the letter should include the matters referred to in paragraph I-9.B of the LSC Audit Guide.

Contracts or engagement letters should also contain an escape clause that would allow, without significant penalty, modification or cancellation made necessary by changes in the law.

ENGAGEMENT CONTRACT MANAGEMENT: ENSURING A QUALITY AUDIT

Because of the needs and expectations of third-party financial statement users, the audit must meet the requirements of OMB Circular A-133 and the LSC Audit Guide. Therefore, prudent management of the audit engagement is crucial. Monitoring the progress of the audit is the most effective way to ensure that your organization receives the type and quality of audit services specified in the written agreement. This is a role that your audit committee can carry out most effectively. The

committee can evaluate the audit while it is taking place, addressing and resolving problems before the audit is completed. It can also review audit results and assist in post-audit quality evaluation. Thus, not only does the audit product improve but the working relationship with the auditor is enhanced.

Monitoring is especially beneficial during the first year of a new auditor's contract and during the audit of a particular unit or segment(s) of your organization that is unique or complex. Furthermore, monitoring is beneficial throughout the term of a multiyear contract: It provides status reports and helps coordinate the auditing firm's activities with the audit's requirements. Monitoring can be accomplished through conferences between the auditor and key auditee staff once the contract is awarded, at the completion of audit field work, and at the conclusion of audit field work. Meeting after the completion of the audit to discuss the draft report can help ensure a clear understanding of the report and its findings. While the responsibility for a quality audit rests ultimately with the auditor, monitoring the work being done as a quality assurance measure is a good idea.

Small Entities

Few small organizations have the resources to thoroughly monitor the work of an auditor. When audit committee members are unavailable within an organization, composing a committee of volunteers outside the organization may be the answer.

USE OF SMALL AND MINORITY FIRMS

OMB Circular A-133 contains policies and standards concerning procurement of audit services from small and minority firms.

The standards are based on several fundamental principles when using public funds to obtain goods and services, including:

- 1) All offers of services should be accorded equal treatment. There should be no favoritism granted to any firm and the relationships, to the maximum extent possible, should be "arms-length."
- 2) To the maximum extent possible, recipients of public funds should use free and open competition to provide the necessary services.
- 3) The relationship between the parties (auditee and auditor) provides rights and remedies. If either party fails to uphold its responsibilities or is forced to do more than is expected under the contract document, legal remedies are available.

OIG ASSISTANCE

Use of the procedures recommended in this document should result in a more effective and useful audit. Please direct questions about audit services procurement to the Chief of Audits at (202) 336-8812.

COMMON AUDIT TERMS

ADVERSE OPINION	An adverse opinion is one in which the auditor states that the financial statements are not fairly presented in conformity with generally accepted accounting principles.
AUDIT	The systematic examination of the assertions or actions of a third party to evaluate conformance to some norm or benchmark.
AUDIT COMMITTEE	A group of individuals appointed by the Board of Directors and given responsibility for overseeing all aspects of audit procurement and monitoring.
AUDIT GUIDE	<i>Legal Services Corporation Audit Guide For Recipients And Auditors</i> , issued by the Legal Services Corporation in November 1996.
"CLEAN" OPINION	A clean or unqualified opinion is one in which the auditor can state, without reservation, that the financial statements are fairly presented in conformity with generally accepted accounting principles.
DISCLAIMER OF OPINION	An auditor's report that states that the auditor is unable to offer a opinion on the fair presentation of all or a portion of the financial statements.
FINANCIAL STATEMENT AUDITS	Audits designed to provide users of financial statements with assurance concerning their reliability.
FINDING	An internal control weakness or instance of noncompliance reported in conjunction with a audit performed in conformity with generally accepted government auditing standards. Findings are normally composed of four elements - condition, criterion/criteria, cause and result. They also are often presented together with a recommendation and management's responses.
GENERALLY ACCEPTED ACCOUNTING PRINCIPLES (GAAP)	Rules and practices necessary at a particular time that represent accepted accounting principles and practices. Accounting principles encompass unwritten rules and written rules. The written rules are commonly referred to as promulgated GAAP. The most authoritative sources of

	GAAP are the American Institute of Certified Public Accountants (AICPA), Financial Accounting Standards Board (FASB), Governmental Accounting Standards Board (GASB), pronouncements of the Securities and Exchange Commission (SEC), and various publications of professional organizations.
GENERALLY ACCEPTED AUDITING STANDARDS (GAAS)	Auditing standards established by the Auditing Standards Board of the American Institute of Certified Public Accountants.
GENERALLY ACCEPTED GOVERNMENT AUDITING STANDARDS (GAGAS)	Auditing standards established by the U.S. General Accounting Office publication <i>Government Auditing Standards</i> (1994), also known as the "Yellow Book." GAGAS for financial statement audits incorporate the field work and reporting standards of GAAS.
INTERNAL CONTROL STRUCTURE	The policies and procedures established by management to ensure the integrity and comprehensiveness of the data collected by the accounting system for use in internal and external financial reports, as well as the overall "control environment" in which the organization operates.
MANAGEMENT LETTER	A letter from the auditor to management describing internal control weaknesses or compliance violations discovered in the course of a financial statement audit.
MANAGEMENT REPRESENTATION LETTER	A letter obtained by the auditor from management acknowledging management's responsibility for the financial statements and asserting that the information they contain is complete.
MATERIALITY	A potential error is considered to be "material" (i.e., important, significant) to the financial statements if it could have the effect of changing a reader's impression of the financial position, results of operations or cash flows. In making judgments concerning a potential error's materiality, auditors consider both its quantitative and qualitative impact.
MATERIAL WEAKNESS	A reportable condition that could have a significant effect upon the fair presentation of the financial statements.
OFFICE OF MANAGEMENT AND BUDGET CIRCULAR	<i>Audits of Institutions of Higher Education and Other Nonprofit Institutions</i> (March 1990). The Circular

A-133	implements a single audit policy for universities and non-profit grantees.
QUALIFIED OPINION	A qualified opinion is one in which the auditor expresses reservations about the fair presentation of the financial statements in conformity with generally accepted accounting principles.
QUESTIONED COSTS	Grant-related charges whose allowability has been questioned by an auditor.
REPORTABLE CONDITION	A significant deficiency in internal controls discovered by the auditor in the course of a financial statement audit.
SEGREGATION OF DUTIES	An internal control procedure whereby no one individual is placed in a position of being able to both commit and conceal an irregularity.
SINGLE AUDIT	Under the Single Audit Act of 1984, an audit that is specifically designed to meet the needs of all federal grantor agencies. Single Audits must be performed in accordance with generally accepted government auditing standards and the provisions of the Office of Management and Budget's (OMB) Circular A-128, <i>Audits of State and Local Governments</i> .
UNQUALIFIED OPINION	An unqualified or "clean" opinion is one in which the auditor can state, without reservation, that the financial statements are fairly presented in conformity with generally accepted accounting principles (GAAP).
"YELLOW BOOK"	An informal name for the U.S. General Accounting Office's 1994 publication <i>Government Auditing Standards</i> , which sets generally accepted government auditing standards.

STATE CPA SOCIETY ADDRESSES AND TELEPHONE NUMBERS

Alabama Society of CPAs

1103 S. Perry Street
P.O. Box 4187
Montgomery, AL 36103
205-834-7650

Alaska Society of CPAs

341 West Tudor Road
Suite 105
Anchorage, AK 99503
907-562-4334

Arizona Society of CPAs

426 North 44th Street
Suite 250
Phoenix, AZ 85008-6501
602-273-0100

Arkansas Society of CPAs

415 N. McKinley, Suite 970
Little Rock, AR 72205-3022
501-664-8739

California Society of CPAs

P.O. Box 44364
San Francisco, CA 94144
415-802-9393

Colorado Society of CPAs

7720 E. Bellevue Avenue
Building 46-B
Englewood, CO 80111-2615
303-773-2877

Connecticut Society of CPAs

179 Allyn St., Suite 201
Hartford, CT 06103-1491
203-525-1153

Delaware Society of CPAs

28 The Commons
3520 Silverside Road
Wilmington, DE 19810
302-478-7442

DC Institute of CPAs

1023 15th St., N.W., 8th Floor
Washington, D.C. 20005-2602
202-659-9183

Florida Institute of CPAs

P.O. Box 5437
Tallahassee, FL 32314
904-224-2727

Georgia Society of CPAs

3340 Peachtree Road, N.E.
Suite 2750
Tower Place
Atlanta, GA 30326
404-231-8676

Hawaii Society of CPAs

P.O. Box 1754
Honolulu, HI 96806
808-537-9475

Idaho Society of CPAs

P.O. Box 2896
Boise, ID 83701
206-344-6261

Illinois CPA Society

222 South Riverside Plaza
Suite 1600
Chicago, IL 60606
312-993-0393

Indiana CPA Society

8250 Woodfield Crossing Blvd
3rd Floor, P.O. Box 40069
Indianapolis, IN 46240-0069
317-726-5000

Iowa Society of CPAs

950 Office Park Road
Suite 300
W. Des Moines, IA 50265-2548
515-223-8161

Kansas Society of CPAs

P.O. Box 5654
Topeka, KS 66605-0654
913-267-6460

Kentucky Society of CPAs

310 West Liberty Street
Suite 604
Louisville, KY 40202
502-589-9239

Society of Louisiana CPAs

P.O. Drawer 73307
Metairie, LA 70033
504-464-1040

Maine Society of CPAs

P.O. Box 7406 DTS
Portland, ME 04112
207-772-9639

Maryland Association of CPAs

P.O. Box 4417
Lutherville, MD 21094-6072
410-296-6250

Massachusetts Society of CPAs

105 Chauncy St, 10th Floor
Boston, MA 02111
617-556-4000

Michigan Association of CPAs

28116 Orchard Lake Road
P.O. Box 9054
Farmington Hills, MI 48333-9054
313-855-2288

Minnesota Society of CPAs

1230 Northwestern Financial Center
7900 Xerxes Avenue South
Minneapolis, MN 55431-9976
612-831-2707

Mississippi Society of CPAs

4500 I-55 North
Highland Village, Suite 246
Jackson, MS 39211
601-366-3473

Missouri Society of CPAs

P.O. Box 419042
275 N. Lindbergh Blvd., Suite 10
St. Louis, MO 63141-9042
314-997-7966

Montana Society of CPAs

P.O. Box 138
44 West 6th Avenue, 3rd Floor
Helena, MT 59624
406-442-7301

Nebraska Society of CPAs

635 South 14th Street, Suite 330
Lincoln, NE 68508
402-476-8482

Nevada Society of CPAs

5270 Neil Road, Suite 102
Reno, NV 89502
702-826-6800

New Hampshire Society of CPAs
3 Executive Park Drive
Bedford, NH 03110
603-622-1999

New Jersey Society of CPAs
425 Eagle Rock Avenue
Roseland, NJ 07068
201-226-4494

New Mexico CPA Foundation
1650 University, NE, Suite 450
Albuquerque, NM 87102-1733
505-246-1699

New York State Society of CPAs
200 Park Ave., 10th Floor
New York, NY 10166-0010
212-973-8383

North Carolina Association of CPAs
P.O. Box 80188
Raleigh, NC 27623
919-469-1040

North Dakota Society of CPAs
University of North Dakota
P.O. Box 9037
Grand Forks, ND 58202-9037
701-777-2443

Ohio Society of CPAs
P.O. Box 1810
Dublin, OH 43017-7810
614-764-2727

Oklahoma Society of CPAs
128 West Hefner Road
Oklahoma City, OK 73114
405-478-4484

Oregon Society of CPAs
10206 S.W. Laurel Street
Beaverton, OR 97005-3209
503-641-7200

Pennsylvania Institute of CPAs
1608 Walnut Street, 3rd Floor
Philadelphia, PA 19103-5445
215-735-2635

Puerto Rico CPA Society
Apartado Postal 71352
San Juan, PR 00936-1352
809-754-1950

Rhode Island Society of CPAs
One Franklin Square
Providence, RI 02903
401-331-5720

South Carolina Association of CPAs
570 Chris Drive
West Columbia, SC 29169
803-791-4181

South Dakota CPA Society
P.O. Box 1798
231 South Phillips Avenue
Suite 250
Sioux Falls, SD 57101-1798
605-334-3848

Tennessee Society of CPAs
P.O. Box 596
200 Powell Place, Suite 120
Brentwood, TN 37024-0596
615-377-3825

Texas Society of CPAs
P.O. Box 560267
Dallas, TX 75356-0267
214-689-6000

Utah Association of CPAs
455 East 400 South, Suite 202
Salt Lake City, UT 84111-3008
801-359-3533

Vermont Society of CPAs
28 Barre Street
P.O. Box 780
Montpelier, VT 05601-0780
802-229-4939

Virginia Society of CPAs
P.O. Box 25087
Richmond, VA 23260
804-270-5344

Washington Society of CPAs
902 - 140th Avenue, N.E.
Bellevue, WA 98005
206-644-4800

West Virginia Society of CPAs
P.O. Box 1142
Charleston, WV 25324
304-342-5461

Wisconsin Institute of CPAs
P.O. Box 1010
Brookfield, WI 53008-1010

414-785-0445

Wyoming Society of CPAs
1910 Thomas Avenue
Cheyenne, WY 82001
307-634-7039